

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER 99-0105
INCOME TAX
For Tax Periods: 1995-1996

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Issue

GROSS INCOME TAX: Resource Recovery System

Authority: IND. CONST. art. 14, § 2; IC §§ 6-1.1-2-1, 6-1.1-12-28.5, 6-2.1-4-3 (1988 and 1993); *Wheeling Steel Corp. v. Fox*, 298 U.S. 193, 56 S.Ct. 773, 80 L.Ed. 1143 (1936); *Indiana Dep't of State Revenue v. Bethlehem Steel Corp.*, 639 N.E.2d 264 (Ind. 1994); *Miami Coal Co. v. Fox*, 203 Ind. 99, 176 N.E. 11 (1931); *Harbor Belt. R. Co. v. Public Serv. Comm'n*, 147 Ind. App. 652, 263 N.E.2d 292 (1970)

The taxpayer protests the Indiana Department of Revenue's disallowance of its resource recovery system deduction.

Statement of Facts

The taxpayer is a Delaware corporation with its commercial domicile and a manufacturing facility in another State. The taxpayer manufactures high quality carbon steel coils. In the first stage of the production process, the taxpayer produces molten iron by combining iron ore, coke and limestone and heating these raw materials in a blast furnace. The taxpayer then combines the molten iron with scrap steel and other ingredients in a Basic Oxygen Furnace (BOF) to produce molten steel. The resulting molten steel is then transported to a continuous caster, where it is formed into slabs as it passes through a series of mold segments and cools. The taxpayer then uses a series of rolling mills to reduce the slab thickness, smooth the surface of the steel, and turn the slab into a salable coil. Other rolling and finishing mills are utilized to finish the coil to customer specifications. As part of the manufacturing process, the taxpayer generates scrap when it trims steel from the edges of the slabs and coils. The taxpayer also generates scrap steel when it produces a coil that does not meet customer specifications due to either non-conforming metallurgical qualities or surface quality. If the

flawed coil cannot be sold in the secondary steel market, the taxpayer uses it in the manufacturing process. These scrapped coils are consumed as raw materials at the BOF. In addition, the taxpayer purchases scrap for use as a raw material at the BOF. The taxpayer claimed a depreciation deduction for its facility as a resource recovery system (RRS) against its federal adjusted gross income tax liability. It also took a resource recovery deduction from its gross income for Indiana gross income tax purposes. The Indiana Department of Revenue (department) disallowed this deduction in an audit. The taxpayer protested the disallowance and a hearing was held. Further facts will be provided as necessary.

GROSS INCOME TAX: Resource Recovery System

Discussion

The taxpayer took a RRS deduction for the manufacturing facility pursuant to IC 6-2.1-4-3(b) as follows:

If for federal income tax purposes a taxpayer is allowed a depreciation deduction for a particular taxable year with respect to a resource recovery system, and if the resource recovery system processes solid waste or hazardous waste, the taxpayer is entitled to a deduction from his gross income for that same taxable year. The amount of the deduction equals the total depreciation deductions that the taxpayer is allowed, with respect to the system, for that taxable year under Sections 167 and 179 of the Internal Revenue Code.

The department denied the RRS deduction because the taxpayer took it for the out-of-state RRS facility. The taxpayer argued that IC § 6-2.1-4-3 does not state that the RRS deduction is restricted to Indiana property. It also submits that the legislature's use of detailed language in other income tax statutes (i.e., IC §§ 6-2.1-3-32 and 6-3-2-2.6) indicates that the General Assembly knows how to restrict an exemption or deduction when it so chooses.

The department finds that the RRS deduction of IC § 6-2.1-4-3 is available only for an RRS located within Indiana for four reasons. First, the rules of statutory construction, simple logic and the state constitution all require it. The legislative history of this deduction clearly shows that the legislature always addressed the RRS deductions of IC §§ 6-1.1-12-28.5 and 6-2.1-4-3 in the same session law. Statutes passed simultaneously at the same session of the legislature and relating to the same subject matter are to be construed *in pari materia*, i.e. in harmony with each other. *E.g., Lutz v. Arnold*, 208 Ind. 480, 500, 193 N.E. 840, 848 (1935). IC § 6-1.1-12-28.5 governs the RRS deduction from the property tax. As such, it has to be interpreted *in pari materia* with IC § 6-1.1-2-1, which identifies the property subject to that tax. *See Ralston v. State*, 218 Ind. 591, 595, 34 N.E.2d 930, 932 (1941) (requiring different parts of the property tax code relating to tax sales to be read together). However, since IC § 6-2.1-4-3 must be construed *in pari materia* with IC § 6-1.1-12-28.5, and IC § 6-1.1-12-28.5 must be construed *in pari materia* with IC § 6-1.1-2-1, it follows that IC § 6-2.1-4-3 must be construed *in pari materia* with IC § 6-1.1-2-1. This last statute states that “[e]xcept as otherwise provided by law, all tangible property

which is within the jurisdiction of this state on the assessment date of a year is subject to assessment and taxation for that year.” *Id* (emphasis added). The department interprets “jurisdiction” as used in IC § 6-1.1-2-1 consistent with IND. CONST. art. 14, § 2, which states that “[t]he State of Indiana shall possess *jurisdiction* and sovereignty *co-extensive with the boundaries declared in the preceding section*[.]” *Id* (emphases added). The department does not interpret the word “jurisdiction” as used in IC § 6-1.1-2-1 as meaning, as the taxpayer’s argument implies, that Indiana can exercise “long-arm” jurisdiction over the out-of-state RRS. See Ind. Trial Rule 4.4(A) (describing acts of, among others, non-residents serving as a basis for jurisdiction). In other words, IC § 6-2.1-4-3, read in the context of the constitutional provision and the other statutes cited in this paragraph, requires the RRS of a gross income taxpayer taking the RRS deduction to be physically located within the legal geographic boundaries of Indiana. “A statute is *prima facie* operative only as to persons or things within the territorial jurisdiction of the lawmaking power which enacted it.” *Harbor Belt. R. Co. v. Public Serv. Comm’n*, 147 Ind. App. 652, 662, 263 N.E.2d 292, 298 (1970).

Second, restricting the deduction to gross income taxpayers who have an RRS physically located in the state is consistent with the “business situs” holdings of the *Miami Coal* and *Bethlehem Steel* opinions. In *Miami Coal* the court stated that “[t]he legal proposition that personal property may obtain an actual situs different from the domicile of its owner and designated by the words ‘business situs,’ has long been recognized in Indiana.” 203 Ind. at 107, 176 N.E. at 14. The court elaborated later in the opinion as to tangible personal property as follows:

The rule of law that tangible personal property may acquire for itself a fixed situs in a state other than that of the domicile of its owner is an absolute rule. Tangible personal property which has acquired such a situs is immune from taxation, when considered as a form of riches upon which to base a tax *in personam* upon its owner. And such a tax, if so fixed upon its owner in a jurisdiction different from that of the fixed situs of the property, violates the Fourteenth Amendment to the federal Constitution. *Delaware, etc. R. Co. v. Pennsylvania* (1905), 198 U.S. 341, 25 S. Ct. 669, 49 L. Ed. 1077.

203 Ind. at 112, 176 N.E. at 16. See also *Wheeling Steel*, 298 U.S. at 209, 56 S.Ct. at 776 (stating that “it is impossible for one state to reach out and tax property in another without violating the Constitution.”) (internal quotation marks omitted). The Indiana Supreme Court extended the “business situs” doctrine to gross income taxation in *Bethlehem Steel II*. See 639 N.E.2d at 269-72, and cases there discussed.

When the legislature enacted the RRS property and gross income tax deductions in 1979, it presumably was aware of the Indiana Supreme Court’s 1931 opinion in *Miami Coal* and the United States Supreme Court’s 1936 opinion in *Wheeling Steel*. See *Stith Petroleum Co. v. Department of Audit and Control*, 211 Ind. 400, 405, 5 N.E.2d 517, 519 (1937) (stating that “the Legislature is presumed to have had before it and to have had in mind the history and decisions of the courts upon [the] subject [of the act in question]”). The 1979 session of the General Assembly did not include any language in IC § 6-1.1-12-28.5, or for that matter in any other property tax

statute of which the department is aware, that limited or overruled the “business situs” holding of *Miami Coal*. It therefore follows that the 1979 legislature intended that holding to apply under the RRS property tax deduction, and under IC § 6-2.1-4-3 as well, since the two statutes must be construed *in pari materia*. If there was ever any doubt that the “business situs” holding of *Miami Coal* applies under the gross income tax, the Indiana Tax and Supreme Courts removed it in their later *Bethlehem Steel* opinions. Due process and the “business situs” rule preclude Indiana from taxing gross income from a source consisting of tangible personal property having a fixed out-of-state business situs. *Wheeling Steel*, 298 U.S. at 209, 56 S.Ct. at 776; *Miami Coal*, 203 Ind. at 112, 176 N.E. at 16. If that is the case, it logically follows that Indiana also cannot grant a deduction from income it is not entitled to tax in the first place. Due process and the “business situs” rule therefore act to restrict the gross income tax deduction of IC § 6-2.1-4-3 only to gross income taxpayers that own a RRS having a “business situs” within this state.

Finding

The taxpayer’s protest is denied.

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